

Internal Revenue Service

Department of the Treasury
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Telephone Number:

Refer Reply To:
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Legend:

Corporation X =

Claimant =

Defendant =

Court =

b =

c =

date 1 =

date 2 =

date 3 =

date 4 =

date 5 =

date 6 =

date 7 =

\$t =

\$u =

\$z =

Dear _____ :

This letter is in response to Corporation X's request for a ruling regarding whether payments it will make to Claimant pursuant to a structured settlement factoring transaction described in § 5891(b)(1) of the Internal Revenue Code are subject to the information reporting requirements of § 6041.

FACTS

Corporation X is a structured settlement assignment company. Corporation X also "factors" structured settlement payments.

On date 1, Claimant entered into a structured settlement agreement ("Agreement") with Defendant relating to the death of her father from a personal injury within the meaning of former § 104(a)(2). Under the Agreement, Defendant was required to make periodic payments to Claimant as damages for the personal injury, including a payment of \$z on date 7. Also, on date 1, Corporation X assumed Defendant's obligations under the Agreement pursuant to a qualified assignment within the meaning of § 130. The Agreement is a structured settlement under § 5891(c)(1).

Claimant, who needed funds to purchase a home and pay for education costs, contacted Corporation X about factoring the \$z payment scheduled to be paid to her on date 7. In the date 2 factoring agreement (Factoring Agreement), Corporation X and Claimant entered into a factoring transaction ("Factoring Transaction") pursuant to which Corporation X agreed to pay to Claimant the following payments:

- an initial lump sum payment of \$u on date 4; and
- b subsequent c payments of \$t, beginning on date 5 and ending on date 6.

Under the Factoring Agreement, Claimant has no right to a factoring payment until it is paid. In addition, Claimant cannot accelerate or commute any factoring payment. Claimant will not have any more rights to the factoring payments than a general creditor of Corporation X. Also, Claimant has no greater rights in the factoring payments than the Claimant had against the structured settlement payments. Corporation X represents that Claimant could exclude the entire \$z payment from income under former § 104(a)(2) had Claimant not entered into the Factoring Transaction.

On date 3, Court issued a final order approving the Factoring Transaction. The final order is a qualified order under § 5891(b)(2).

LAW

Section 6041(a) provides that, generally, all persons engaged in a trade or business that pay another person \$600 or more of fixed or determinable income in the course of that trade or business must file an information return setting forth the amount of the payment and the recipient of the payment. Payments that are excludable from the recipient's gross income under § 104(a)(2) are not subject to information reporting under § 6041.

Section 61(a) provides that except as otherwise provided in subtitle A, gross income means all income from whatever source derived.

Section 104(a)(2) as in effect prior to the amendments made by § 1605 of the Small Business Job Protection Act of 1996 ("1996 Act") provided, in general, that gross income does not include the amount of any damages received (whether by suit or agreement and whether as lump sums or periodic payments) on account of personal injuries or sickness. Section 1605(d)(2) of the 1996 Act provides that the amendments made by § 1605(a) to § 104(a)(2) do not apply to any amount received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

Section 5891(d) provides that if the applicable requirements of sections 72, 104(a)(1), 104(a)(2), 130, and 461(h) were satisfied at the time that the structured settlement (as defined in § 5891(c)(1)) involving structured settlement payment rights (as defined in § 5891(c)(2)) was entered into, the subsequent occurrence of a structured settlement factoring transaction (as defined in § 5891(c)(3)) shall not affect the application of the provisions of such sections to the parties to the structured settlement (including an assignee under a qualified assignment under section 130) in any taxable year.

Section 451 provides that the amount of any item of gross income shall be included in the gross income of the taxpayer for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, the amount is to be accounted for as of a different period. Section 1.451-1(a) of the Income Tax Regulations likewise provides that under the cash receipts and disbursements method of accounting, income must be included in gross income when actually or constructively received.

Rev. Rul. 79-220, 1979-2 C.B. 74, involves an insurance company that had a continuing obligation to pay an amount monthly to an individual for an agreed period of time in settlement of a suit for personal injuries. The insurance company purchased a single premium annuity from another insurance company as an investment to provide a source

of funds to satisfy its obligation to the individual. The ruling holds that the exclusion from gross income provided by § 104(a)(2) applies to the full amount of the monthly payments received by the individual because the individual had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump sum amount that was invested to yield the monthly payments.

Amounts that are not taxable under actual or constructive receipt principles or the economic benefit doctrine nevertheless may satisfy the requirements for inclusion in income under the doctrine of cash equivalency. Under this doctrine, a taxpayer is treated as having income when the taxpayer receives property that is the “equivalent of cash.” Decisions in cases involving cash equivalency have been based on the facts and circumstances of particular cases. In situations where a contract provided for deferred payments and no notes or other evidences of indebtedness were given, the contract rights, which in the situations described were not of a type commonly sold or given as part of a purchase price, were held not to be property and, therefore, not a cash equivalent. *Ennis v. Commissioner*, 17 T.C. 465 (1951); *Johnson v. Commissioner*, 14 T.C. 560 (1950). *Compare* Rev. Rul. 68-606, 1968-2 C.B. 42 (obligor’s payments to make future installment payments is a cash equivalent, even though contained only in a contract if the rights under the contract are freely transferable and readily saleable).

DISCUSSION

As a result of the factoring agreement, Claimant has received an initial lump sum payment of \$u on date 4, and has and will receive b subsequent payments of \$t, beginning on date 5 and ending on date 6 for her right to receive \$z on date 7, thereby closing the transaction as to that portion of Corporation X’s periodic payment obligation. Consequently, if the Agreement was not readily saleable, and the Claimant uses the cash method of accounting, Claimant’s receipt of Corporation X’s payment of \$u on date 4 and subsequent payments of \$t beginning on date 5 and ending on date 6 results in income of the same character as would have been received absent the factoring agreement. *Cf.* § 1.83-7(a).

CONCLUSION

Based strictly on the information submitted and representations made, we conclude that Corporation X is not subject to the information reporting requirements of § 6041 with respect to the \$u lump sum payment and each \$t payment it makes to Claimant pursuant to the Factoring Agreement because each payment is damages received on account of personal injuries or sickness under § former 104(a)(2) but only if—

- Claimant uses the cash method of accounting;
- Each of the payments that were made or were to be made under the Agreement were excludable from gross income under former § 104(a)(2);

- Corporation X's assumption of Defendant's obligations was a qualified assignment under § 130;
- The Agreement was not readily saleable when Claimant and Corporation X entered into the Factoring Transaction;
- The aggregate amount of payments that Corporation X makes pursuant to the Factoring Transaction do not exceed \$z;
- Each payment that Corporation makes pursuant to the Factoring Transaction is due, payable, and paid on or before date 6 (which precedes date 7); and
- The Factoring Transaction is a structured settlement factoring transaction described in § 5891(b)(1) and is valid under applicable state laws.

Except as expressly set forth in the preceding paragraph, no opinions are expressed concerning the tax consequences of the transactions described in this letter under any provision of the Internal Revenue Code.

The taxpayer must attach a copy of this letter to any income tax return to which it is relevant. If the taxpayer files its returns electronically, it may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling. See section 7.05 of Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 27.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. Enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110.

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this letter ruling to the taxpayer's authorized representative.

Sincerely,

Michael J. Montemurro
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)